CUSHMAN & WAKEFIELD
NorthMarq

JANUARY 2017

COMPASS

Navigating the Minneapolis/St. Paul Commercial Real Estate Market

EXECUTIVE SUMMARY

OVERALL MARKET TRENDS

Twin Cities Multi-Tenant Market Holds Steady Course of Slow Improvement

VACANCY RATE
10.6%
Landlords repositioning assets, offering more attractive options

ABSORPTION
2.12 million square feet
Boosted by strong demand for Industrial space

NEW CONSTRUCTION
1.9 million SF
Activity remains high even as costs rise

SECTOR HIGHLIGHTS

INDUSTRIAL: Northwest submarket leads uptick in leasing activity

INVESTMENT & CAPITAL MARKETS: Multi-family sales hit record high

OFFICE: Surplus of space in Minneapolis creates speed bump

RETAIL: Occupancy remains strong despite wave of store closures

MEDICAL OFFICE: Demand steady amid shifting healthcare landscape

MULTI-FAMILY: Twin Cities vacancy rate is lowest in the country

LAND: Higher construction costs put pressure on prices

HOTELS: Growth will slow as sector approaches the peak

Photo Credit: VisitSaintPaul.com

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The Twin Cities multi-tenant market continued to tighten and take shape throughout the second half of 2016. With few exceptions, vacancy rates remain low and demand remains high, and we expect activity to remain strong and the market to remain competitive heading into 2017.

— Mike Ohmes, Executive Vice President-Transaction & Advisory Services

INDUSTRIAL

Leasing Momentum Continues

930,766 SF

of absorption

Industrial proved to have more gas in the tank to pull out a strong finish in 2016. Second-half absorption nearly doubled the forecast of 550,000 SF.

Signs that employers are continuing to hire and expand should help maintain momentum going into 2017. More than 1.1 MSF of positive absorption is predicted for the first half of the year.

610

Robust demand in the Northwest submarket is expected to fuel build-to-suit and speculative construction in the Hwy. 610 corridor in the coming year.

SW

Building sales remained active in all submarkets, particularly in the Southwest, which saw prices rising to new highs—even for older, less-functional properties with clear heights lower than 20 feet. That situation seems likely to continue into 2017 as well-capitalized buyers keep aggressively hunting for deals in the best locations.

INVESTMENT & CAPITAL MARKETS

Buyer demand outweighs available supply

$4.6B

in commercial and multi-family sales

Strong investor demand continues across all sectors as buyers seek higher-yielding investments in secondary markets like the Twin Cities.

MF 50%

Multi-family continues to break records in pricing and sales volume. Transactions jumped 50% to $1.5 billion in 2016.

Despite lack of inventory, office reported a near-record year of $1.4 billion in closed transactions with notable sales, including 33 South Sixth-City Center and Ameriprise Financial Center.

$1.4B

Although buyers remain discerning, there is an appetite for both high-quality, stabilized properties as well as clear value-add plays with NOI growth and upside potential.

INTEREST RATES

An interest rate hike will have an impact on future transactions. However, capital is expected to remain plentiful and relatively cheap compared with historical levels.

LAND

Prices near the peak

INTENSE DEMAND

for single-family residential land

As speculative bargains have disappeared, the land market is once again being dominated by developers looking to build immediately.

Although many of the best multi-family sites have already been snapped up, there continues to be steady demand for apartment sites in both Minneapolis and the suburbs.

Demand for industrial land remains high. However, amid rising labor and building costs, occupiers are more price-sensitive.

Despite returning demand from home-buyers, residential developers are proceeding cautiously. Homebuilders are also wary of overpaying for land, especially as higher construction costs are squeezing profit margins.

HOTELS

Inventory expands as market nears its peak

ADR Climbs 5.5%

to $119.22

The Twin Cities hotel industry is approaching a cyclical peak and the forecast calls for slower growth ahead in key fundamentals.

Hotels have enjoying a prolonged upswing with 76 consecutive months of revenue and rate growth.

The building boom continued in 2016 with 3,100 new rooms delivered and another 4,900 rooms planned or under construction for 2017. Developers are starting to tap the brakes amid signs of slower growth ahead.

FOR SALE

It remains a seller's market, but values have likely hit the high-water mark as investors are expected to be less willing to pay premium prices going forward.

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OFFICE
Headwinds slow recovery

-336,793 SF
total absorption for 2016

The Twin Cities office market took a step back in its recovery in the second half of 2016 with metro-wide absorption that ended the year in negative territory. However, the overall health of the office market is more positive than those numbers suggest.

Longer-term leases are more prevalent, which has contributed to an environment where there is less lease rollover and greater stability in market rents.

While new development remains scarce, both downtown and suburban landlords are moving forward with major renovations that will help to fill vacancies and provide added pricing power on rent growth.

CBD

Minneapolis CBD is at ground zero for surplus space returning to the market, notably due to a handful of big moves. At the same time, Downtown Minneapolis is benefitting from tenants, including Amazon, that are returning to the urban core.

RETAIL
Race to backfill begins

7.7% vacancy
reflecting competitive market

Retail remains on solid footing despite a spike in store closures. Restaurants, coffee shops and grocers are among those sectors that still have a big appetite for expansion.

CLOSED

Store closures are creating new opportunities in prime trade areas where vacancy remains tight. Plans are well underway to backfill vacancies created by a wide range of retailers from Sports Authority to Sears.

The grocery war is heating up. New entrants such as Fresh Thyme Farmers Market and Hy-Vee are competing for sites and market share among a deep pool of established players, specialty grocers and discount clubs.

6.75%

Investors continue to battle a shortage of for-sale property. Grocery-anchored properties remain the most coveted by institutional investors with quality grocery-anchored properties trading at cap rates of 5-6.75%.

MEDICAL OFFICE
Slow and steady course

446,278 SF
of new space completed in 2016

The Twin Cities medical office market remains healthy with a low vacancy rate, a slight bump in rental rates and a strong investor appetite.

V A

Demand for multi-tenant space continued but at a slower pace. Although vacancy improved to 10.8%, little absorption occurred as no new multi-tenant space was delivered in the second half.

Construction activity remains robust with 446,278 SF delivered in 2016 and another 459,000 SF in the pipeline for 2017. System-driven, single-user buildings are dominating new construction.

Changes within the healthcare sector, such as consolidation, doctor shortages and new service models, are continuing to impact real estate requirements.

MULTI-FAMILY
Occupancies, investment sales hit new highs

2.5% vacancy
lowest in the U.S.

The multi-family sector remains white-hot with historically low vacancy, above-average rent growth, robust development and a record year of investment sales.

$$$$

Rental rates continue to grow at a healthy pace with a metro-wide average annual growth rate of 5.3% as of third quarter.

Developers have been delivering a steady supply of new space to the market since 2012, including an estimated 3,900 market-rate units completed in 2016.

Value-add conversions are dominating investment sales. Apartment sales surpassed a record-high $1.5 billion in 2016, and all but $130 million of those deals included Class B and Class C assets.

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PROJECTIONS FOR FIRST HALF 2017

DEMAND FOR SPACE

Demand for space remains strong across all property types

CONTINUED IMPROVEMENT

Continued improvement in absorption and vacancy expected with headwinds in Minneapolis CBD office space

INVESTMENT TARGET

Twin Cities remains an attractive investment target, including white-hot multi-family market

MARKET QUICK FACTS

TWIN CITIES METRO DEFINITION

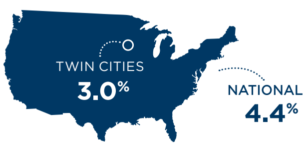
The "Twin Cities" of Minneapolis and St. Paul form the core of a metropolitan region encompassing 6,046 square miles and consisting of 13 counties: Anoka, Carver, Dakota, Hennepin, Ramsey, Scott, Washington, Isanti, Chisago, Sherburne and Wright in Minnesota, as well as Pierce and St. Croix counties in Wisconsin.

HOUSING PRICES ARE UP

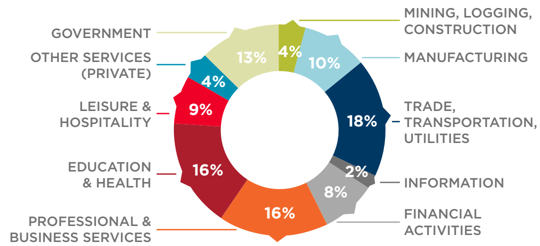
The Twin Cities median single-family home price is $232,000, up 5.5% compared with $220,000 in fourth-quarter 2015.

Source: MAAR

UNEMPLOYMENT RATE REMAINS HISTORICALLY LOW



LABOR FORCE MIX IS CONSISTENTLY SOLID



BUSINESS STRENGTHS

Major business strengths in the Twin Cities include a highly educated workforce, excellent transportation services, a diverse economic base and available capital. The metro area is home to 17 Fortune 500 companies representing a broad spectrum of industries. The Minneapolis-St. Paul area's employment base does not rely on any single industry, which allows it to weather recessions and economic downturns in specific industries.

More per capita **Fortune 500** companies than any other US metro region *Forbes, 2016*

Minnesota is the **#1 state** for business *CNBC*

The **6th** most inventive city worldwide *Bloomberg Businessweek*

North Loop ranks a **Top 25** Destination in the World *Fodors, 2016*

ABOUT THE AUTHOR

THE COMPASS REPORT

The report was created by experts using Twin Cities commercial property data from the last six months of 2016. The data used for this report has been obtained from sources which we deem reliable. While every effort has been made to report accurate data, Cushman & Wakefield NorthMarq cannot guarantee the accuracy of this market report. Furthermore, we cannot assume responsibility for any omission of data which may occur. It is our intent to provide the best possible information regarding the office, industrial, land, retail, multifamily and investment markets while leaving the reader the responsibility of further verification before using this report for business and/or financial decisions. The Compass report includes information for multi-tenant office, industrial and retail projects greater than 20,000 sq. ft. and multi-family for-rent properties. Not included are owner occupied, government or single-tenant buildings. Not all information and insights we've collected can be published in any given volume.

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Cushman & Wakefield NorthMarq operates the Minnesota business of Cushman & Wakefield, a leading global real estate services firm that helps clients tranSForm the way people work, shop, and live. The firm offers innovative solutions to its occupier and investor clients within the Minneapolis/St Paul region and around the world. A recognized leader in real estate research, the firm publishes a broad array of proprietary reports.

#1 Commercial Real Estate Brokerage Firm & Commercial Property Management Firm
by Minneapolis/St Paul Business Journal

Best of Business by *Twin Cities Business*

More than $2.3 billion annual transactions

43 MSF of assets under management

Employs nearly 500 professionals

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